



**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)  
  
Financial Statements  
  
June 30, 2005 and 2004  
  
(With Independent Auditors' Report Thereon)

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

**Table of Contents**

	<b>Page</b>
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-8
Statements of Fiduciary Net Assets	9
Statements of Changes in Fiduciary Net Assets	10
Notes to Financial Statements	11-24



**KPMG LLP**  
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## **Independent Auditors' Report**

Division of Retirement and Benefits  
Retiree Health Fund:

We have audited the accompanying statements of fiduciary net assets of the State of Alaska Retiree Health Fund (Plan), a Pension Trust Fund of the State of Alaska, as of June 30, 2005 and 2004, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the State of Alaska Retiree Health Fund and do not purport to and do not present fairly the financial position of the State of Alaska as of June 30, 2005 and 2004, changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting standards generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Retiree Health Fund (Plan), a Pension Trust Fund of the State of Alaska, as of June 30, 2005 and 2004, and the changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.



Division of Retirement and Benefits  
Retiree Health Fund

The accompanying required supplementary information of management's discussion and analysis on pages 3 to 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 30, 2005, except as to note 7,  
which is as of October 28, 2005

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2005 and 2004

This section presents management's discussion and analysis (MD&A) of the Retiree Health Fund's (Plan) financial condition and performance for the years ended June 30, 2005 and 2004. This section is presented as a narrative overview and analysis. Please read the MD&A in conjunction with the financial statements and notes to the financial statements to better understand the financial condition and performance of the Plan during the fiscal years ended June 30, 2005 and 2004. Prior fiscal years' information for 2003 is presented for comparative purposes.

**Financial Highlights**

The Plan's total current assets exceeded its total current liabilities by \$236,295,867 and \$173,957,575 at the close of fiscal years 2005 and 2004, respectively.

The Plan's net assets as of June 30, 2005 and 2004 increased by \$62,338,292 and \$29,087,444 or 35.8% and 20.1% over the closing balances of those assets in fiscal years 2004 and 2003, respectively.

Total health premiums received totaled \$319,221,517 and \$279,357,433 during fiscal years 2005 and 2004, increases of \$39,864,084 and \$38,606,918 or 14.3% and 16.0% from fiscal years 2004 and 2003, respectively.

Net investment earnings increased from \$10,485,729 to \$14,142,830 during fiscal year 2005 and increased from \$9,514,374 to \$10,485,729 during fiscal year 2004; reflecting increases of 34.9% and 10.2% from fiscal years 2004 and 2003, respectively.

Benefit payments totaled \$259,433,330 and \$230,478,237 during fiscal years 2005 and 2004, increases of \$28,955,093 and \$24,301,986 or 12.6% and 11.8% from fiscal years 2004 and 2003, respectively.

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Plan's basic financial statements. The Plan's basic financial statements are comprised of three components: (1) statement of fiduciary net assets, (2) statement of changes in fiduciary net assets, and (3) notes to the financial statements.

*Statement of Fiduciary Net Assets* – This statement presents information regarding the Plan's assets, liabilities, and net assets. Net assets represent the total amount of assets less the total amount of liabilities. The Statement of Fiduciary Net Assets classifies assets, liabilities and net assets as current, noncurrent and restricted.

*Statement of Changes in Fiduciary Net Assets* – This statement presents how the Plan's net assets changed during the fiscal year as a result of contributions, investment income, benefit payments, administrative expenses, and transfers.

The above statements represent resources available for investment and the payment of benefits as of the fiscal year-end and the sources and uses of those funds during the fiscal year.

*Notes to the Financial Statements* – The notes to the financial statements are an integral part of the financial statements and provide additional detailed information and schedules to better understand the Plan's financial statements.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2005 and 2004

**Condensed Financial Information**

Description	Net Assets				
	2005	2004	Increase/(decrease)		2003
			Amount	Percentage	
Assets:					
Cash and receivables	\$ 62,279,511	52,389,606	9,889,905	18.9%	48,078,572
Securities lending collateral	14,383,422	30,225,352	(15,841,930)	(52.4)	19,075,600
Investments, at fair value	222,679,571	166,521,461	56,158,110	33.7	137,964,954
Total assets	299,342,504	249,136,419	50,206,085	20.2	205,119,126
Liabilities:					
Estimated claims incurred but not paid	46,270,000	42,900,000	3,370,000	7.9	38,750,000
Accrued expenses	751,761	1,062,291	(310,530)	(29.2)	1,217,771
Securities lending collateral payable	14,383,422	30,225,352	(15,841,930)	(52.4)	19,075,600
Other liabilities	1,641,454	991,201	650,253	65.6	1,205,624
Total liabilities	63,046,637	75,178,844	(12,132,207)	(16.1)	60,248,995
Total net assets	\$ 236,295,867	173,957,575	62,338,292	35.8%	144,870,131

Description	Changes in Net Assets				
	2005	2004	Increase/(decrease)		2003
			Amount	Percentage	
Net assets, beginning of year	\$ 173,957,575	144,870,131	29,087,444	20.1%	110,229,934
Additions:					
Health insurance premiums	319,221,517	279,357,433	39,864,084	14.3	240,750,515
Net investment income	14,142,830	10,485,729	3,657,101	34.9	9,514,374
Total additions	333,364,347	289,843,162	43,521,185	15.0	250,264,889
Deductions:					
Benefits	259,433,330	230,478,237	28,955,093	12.6	206,176,251
Administrative expenses	11,592,725	10,277,481	1,315,244	12.8	9,448,441
Transfer out	—	20,000,000	(20,000,000)	(100.0)	—
Total deductions	271,026,055	260,755,718	10,270,337	3.9	215,624,692
Increase in net assets	62,338,292	29,087,444	33,250,848	114.3	34,640,197
Net assets, end of year	\$ 236,295,867	173,957,575	62,338,292	35.8%	144,870,131

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2005 and 2004

**Financial Analysis of the Plan**

The Statements of Fiduciary Net Assets as of June 30, 2005 and 2004 showed total assets exceeding total liabilities by \$236,295,867 and \$173,957,575, respectively. These amounts represent the total plan assets held in trust for postemployment healthcare benefits on each of those dates. The entire amount is available to cover the Plan's obligations to pay benefits for its members and their beneficiaries.

These amounts also represent increases in net assets of \$62,338,292 and \$29,087,444, or 35.8% and 20.1% over fiscal years 2004 and 2003, respectively. Over the long term, health premiums collected are expected to cover all claims costs to the Plan. With continued increases in health care costs, the Plan must continue to accumulate assets so that there are funds available to meet current and future claims costs.

The investment of Plan funds is a long-term undertaking. On an annual basis, the Commissioner of Revenue reviews the asset allocation policies of the retiree major medical and retiree long term care funds and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the Plan's constraints and objectives. During fiscal years 2005 and 2004, the Department of Revenue allocated Retiree Major Medical assets in the following manner: 30% in the short-term fixed income pool, 30% in the intermediate-term fixed income pool, and 40% in the broad market fixed income pool. In fiscal years 2005, long term care assets were allocated in the following manner: 33% in the broad market fixed income pool, 18% in the international equity pool, 48% in the domestic equity account, and 1% in the short-term fixed income pool. In fiscal years 2004, long term care assets were allocated in the following manner: 34% in the broad market fixed income pool, 20% in the international equity pool, 45% in the domestic equity account, and 1% in the short-term fixed income pool.

**Premium Calculations**

The overall objective of the health fund is to have sufficient funds to meet claim costs for the Plan. The premiums are set each year by the Division's benefit consultant with the Division's and the governing body's concurrence and the Commissioner's approval. Premiums are based on a calendar year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next calendar year.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2005 and 2004

**Health Insurance Premiums and Investment Income**

The revenues required to finance postemployment healthcare benefits are accumulated through a combination of pension system health premiums, member health premiums and investment income.

	Revenues				
	2005	2004	Increase/(decrease)		2003
			Amount	Percentage	
Employer health premiums	\$ 279,110,797	243,900,978	35,209,819	14.4%	210,073,525
Member health premiums	36,000,065	32,566,084	3,433,981	10.5	30,201,841
Other	4,110,655	2,890,371	1,220,284	42.2	475,149
Net investment income	14,142,830	10,485,729	3,657,101	34.9	9,514,374
Total	<u>\$ 333,364,347</u>	<u>289,843,162</u>	<u>43,521,185</u>	<u>15.0%</u>	<u>250,264,889</u>

Health premiums increased from \$720 per year per person during calendar year 2003 to \$806 per year per person during calendar year 2004 to \$850 during calendar year 2005, due to increasing costs associated with covered benefits.

Other income represents prescription drug rebates, which have increased in the last two years due to the greater utilization by Plan members.

Investment income increased by \$3,657,101 and \$971,355 or 34.9% and 10.2% over amounts recorded in fiscal year 2004 and 2003, thereby providing an increase to net assets of the Plan over the same period. Changes in both years are due to the performance of the equity and fixed income markets. Returns in the equity markets in fiscal year 2004 were in excess of 20% compared to a negative return in fiscal year 2003. Likewise, returns in these markets in fiscal year 2005 were back in the 4.5% range for domestic securities and 15% range for international securities. The Plan's investment in equities represents more than twenty four percent of total investments. Returns in the domestic fixed income market was less than one percent in fiscal year 2004 and in excess of 7% in fiscal year 2005. The Plan's investment in domestic fixed income represents more than seventy five percent of total investments.

**Benefits and Expenses**

The primary expense of the Plan is the payment of postemployment healthcare benefits. These benefit costs and the cost of administering the Plan comprises the costs of operation.

	Expenses				
	2005	2004	Increase/(decrease)		2003
			Amount	Percentage	
Healthcare benefits	\$ 259,433,330	230,478,237	28,955,093	12.6%	206,176,251
Administrative expenses	11,592,725	10,277,481	1,315,244	12.8	9,448,441
Transfer out	—	20,000,000	(20,000,000)	100.0	—
Total	<u>\$ 271,026,055</u>	<u>260,755,718</u>	<u>10,270,337</u>	<u>3.9%</u>	<u>215,624,692</u>



**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Management's Discussion and Analysis

June 30, 2005 and 2004

Benefit payments had increases of \$28,955,093 and \$24,301,986 or 12.6% and 11.8% from fiscal years 2004 and 2003. With health care costs continuing to trend higher as well as increases in the number of retirees each fiscal year, further increases to healthcare benefit payments are expected. The Plan's benefit consultants identified and developed premiums necessary to cover the increased claims costs.

During fiscal year 2004, a review was conducted of all medical reserve amounts. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. The result was an excess amount of net assets not specifically identified to other reserves. The excess amount was then returned to the respective retirement system. There is an earnings differential on invested assets between the base trust fund and the Plan. Earnings on such excess reserves should remain with the base retirement trust. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive.

Based on this review, the Plan transferred \$20,000,000 to the four contributing retirement systems. The transfers were as follows

Public Employees' Retirement System	\$	13,724,000
Teachers' Retirement System		6,200,000
Judicial Retirement System		50,000
Elected Public Officials Retirement System		26,000

### **Funding**

Postemployment healthcare benefits are funded by premiums received from the respective retirement systems and plan members as well as from income earned on the Plan's investments. Health premiums are set each year by the Division's consultant with the Division's and governing body's concurrence and the Commissioner's approval.

### **Economic Conditions, Market Environment, and Results**

There are three plans financed through the Retiree Health Fund: major medical (mostly paid by the respective retirement funds), the Dental-Vision-Audio (DVA) and Long-Term Care (LTC) plans (both paid for by the retirees only). The overall objective of the Plan is to have sufficient funds to meet current and future claim costs for the retiree health plans. The premiums for the major medical and DVA plans are calculated each year based on the anticipated claims and administrative costs for the following year. The benefit consultant reviews the historical claims experience and administrative costs and uses that data to estimate trends to develop premiums for the next calendar year. The amount of restricted and unrestricted reserves is considered when setting the premiums. The premiums for the LTC plan have been developed to provide future benefits for the retirees, much like an annuity. The LTC plan will accumulate large reserves to pay future benefits.

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)  
Management's Discussion and Analysis  
June 30, 2005 and 2004

**Requests for Information**

This financial report is designed to provide a general overview of the Plan's financial condition for all those with interest in the Plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State of Alaska, Division of Retirement and Benefits, Accounting Section, P.O. Box 110203, Juneau, Alaska 99811-0203.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Statements of Fiduciary Net Assets

June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents (notes 3 and 4):		
Investment in State of Alaska General Fund and other nonsegregated investments pool	\$ 13,204,722	11,950,807
Short-term fixed income pool	48,801,087	40,298,469
Securities lending collateral	14,383,422	30,225,352
Total cash and cash equivalents	<u>76,389,231</u>	<u>82,474,628</u>
Investments (notes 3 and 4):		
Broad market fixed income pool	102,261,246	77,921,033
Domestic equity account	50,458,975	38,035,461
Intermediate-term fixed income pool	51,343,693	34,022,448
International equity pool	18,615,657	16,542,519
Total investments	<u>222,679,571</u>	<u>166,521,461</u>
Premiums receivable	120,612	107,146
Interest and dividends receivable	153,090	33,184
Total assets	<u>299,342,504</u>	<u>249,136,419</u>
Current liabilities:		
Estimated claims incurred but not paid (note 5):		
Medical, dental, visual and audio	38,970,000	36,500,000
Long-term care	7,300,000	6,400,000
Total estimated claims incurred but not paid	<u>46,270,000</u>	<u>42,900,000</u>
Accrued expenses	751,761	1,062,291
Due to State of Alaska General Fund	1,641,454	991,201
Securities lending collateral payable (note 4)	14,383,422	30,225,352
Total liabilities	<u>63,046,637</u>	<u>75,178,844</u>
Contingency (note 7)		
Held in trust for pension benefits and other purposes:		
Major medical	125,987,400	82,954,701
Dental, visual and audio	10,572,219	9,671,722
Long-term care	99,736,248	81,331,152
Total net assets held in trust for postemployment healthcare benefits and other purposes	<u>\$ 236,295,867</u>	<u>173,957,575</u>

See accompanying notes to basic financial statements.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Statements of Changes in Fiduciary Net Assets

Years ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Additions:		
Contributions:		
Employer health insurance premiums	\$ 279,110,797	243,900,978
Member health insurance premiums	36,000,065	32,566,084
Other	4,110,655	2,890,371
Total contributions	<u>319,221,517</u>	<u>279,357,433</u>
Investment income:		
Net appreciation in fair value (note 3)	5,714,514	3,989,229
Interest	7,638,436	5,759,496
Dividends	1,398,512	975,942
Total investment income	<u>14,751,462</u>	<u>10,724,667</u>
Less investment expense	<u>608,632</u>	<u>238,938</u>
Net investment income	<u>14,142,830</u>	<u>10,485,729</u>
Total additions	<u>333,364,347</u>	<u>289,843,162</u>
Deductions:		
Benefits	259,433,330	230,478,237
Administrative expenses	11,592,725	10,277,481
Transfer out (note 6)	—	20,000,000
Total deductions	<u>271,026,055</u>	<u>260,755,718</u>
Net change in fiduciary net assets	<u>62,338,292</u>	<u>29,087,444</u>
Net assets, beginning of year	<u>173,957,575</u>	<u>144,870,131</u>
Net assets, end of year	<u>\$ 236,295,867</u>	<u>173,957,575</u>

See accompanying notes to basic financial statements.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(1) Description**

The following brief description of the State of Alaska Retiree Health Fund (Plan), a pension trust fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

***General***

The Plan was established to provide self-insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is a pension trust fund of the State financial reporting entity and is included as such in the State's comprehensive annual financial report. As of June 30, 2005 and 2004, there were approximately 27,400 and 26,100 retirees, respectively, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for retirees were fully insured through the payment of premiums to an insurance company.

***Benefits***

The Plan offers major medical, voluntary dental-visual-audio (DVA) and voluntary long-term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

**Medical**

The Plan provides medical benefits to qualified benefit recipients of the Retirement Systems. The Retirement Systems pay the medical premiums for the benefit recipients, except for the following who must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) first hired under the PERS on or after July 1, 1986, who are under age 60, are not receiving a disability benefit, and had less than 25 years of police/fire service or less than 30 years of other service.
- Benefit recipients of the Teachers' Retirement System (TRS) first hired under the TRS on or after July 1, 1990, who are under age 60, are not receiving a disability benefit, and had less than 25 years of service.
- Benefit recipients of the PERS first hired under the PERS on or after July 1, 1996, who are age 60 or older and do not have at least 10 years of credited service.
- Alternate payees under a Qualified Domestic Relations Order (QDRO).

The State also pays the medical premiums for benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(1) Description (cont.)**

**Voluntary DVA and LTC**

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

***Administration***

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, Aetna, to process all medical, dental, and prescription drug claims.

***Funding***

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from the Retirement Systems and benefit recipients, as applicable. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The Retirement Systems retain the risk of loss of allowable claims.

Amounts due to the State of Alaska General Fund represent reimbursements to be made by the Plan to other funds for net payments made by other plans on behalf of the Plan.

**(2) Summary of Significant Accounting Policies**

***Basis of Accounting***

The Plan's financial statements are prepared using the economic resource focus and the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Investments***

Investments are recorded at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than in a forced or liquidation sale." Security transactions are accounted for on a trade date (ownership) basis at the current fair value. Dividend income on domestic and international equity securities is accrued on the ex-dividend date.

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(2) Summary of Significant Accounting Policies (cont.)**

In fiscal year 2005, Governmental Accounting Standards Board (GASB) Statement 40, *Deposits and Investment Risk Disclosures* was implemented. GASB Statement No. 40 addresses disclosures on deposits and investments, focusing on common investment risks related to interest rate risk, credit risk, foreign currency risk and concentration of credit risk.

Fixed income and international equity securities are valued each business day using an independent pricing service. The securities underlying the domestic equity account are valued each business day by the Trustee Committee in good faith and pursuant to procedures established by the Trustee. The domestic equity account's net asset value per share is determined by dividing the fair value of its underlying assets by the number of units that represent total ownership. Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Money markets are valued at amortized cost, which approximates fair value.

The cost of securities is determined on the average cost basis.

With the exception of General Fund and Other Non-segregated Investments (GeFONSI) and short-term fixed income pool, income from pooled securities is allocated daily to each pool participant on a pro rata basis. Income in the short-term fixed income pool is calculated daily and credited monthly to each participant on a pro rata basis. GeFONSI income is distributed to pool participants monthly if prescribed by statute or if appropriated by state legislature. Domestic equity income is distributed quarterly.

***Federal Income Tax Status***

The Plan is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code.

***Reclassifications***

Certain reclassifications not affecting changes in fiduciary net assets have been made to 2004 amounts in order to conform to the 2005 presentation.

**(3) Investments**

The State has created a pooled environment by which it manages investments. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division, or by contracted external investment managers. The Plan invests in the State's internally managed GeFONSI, short-term, broad marked and intermediate-term fixed income pools as well as the State's externally managed domestic equity account and international equity pool. A complete description of the investment policy for each pool is included in the *Department of Revenue, Treasury Division, Policies and Procedures*.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

***General Fund and Other Non-Segregated Investment (GeFONSI) Pool***

The Plan participates in the State's internally managed GeFONSI pool which consists of investments in the State's internally managed short-term and intermediate-term fixed income pools. At June 30, 2005 and 2004, the Plan had a 0.79% and 1.08% ownership in the GeFONSI.

***Short-Term Fixed Income Pool***

The Plan participates in the State's internally managed short-term fixed income pool which was established March 15, 1993, with a start up and maintained share price of \$1. Treasury staff determines the allocation between permissible securities. Each participant owns shares in the pool, the number of which fluctuates daily with contributions and withdrawals. Participant shares also change at the beginning of each month when income is paid. Participants include the intermediate-term and broad market fixed income pools. At June 30, 2005 and 2004, the Plan had a 2.59% and 2.34% direct ownership in the short-term fixed income pool.

***Broad Market Fixed Income Pool***

The Plan participates in the State's internally managed broad market fixed income pool which was established July 1, 1994, with a start up share price of \$1,000. The share price at June 30, 2005, was \$2,143. Treasury staff determines the allocation between permissible securities. When compared to the short or intermediate-term fixed income pools, this pool has a longer time horizon, a more limited need for liquidity, a moderate need for long-term inflation protection, and can be invested at a high risk level. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, the Plan had a 10.87% and 9.62% direct ownership in the broad market fixed income pool.

***Domestic Equity Account***

The Plan participates in the State's externally managed domestic equity account. The participants in this account hold shares in the Russell 3000 Index Common Trust Fund (Trust), a passively managed commingled index fund. The Trust includes other non-State institutional investors. The investment objective of the Trust is to replicate, as closely as possible, the return of the Russell 3000 Stock Index and thus is comprised of securities included in that index. Ownership in a common trust is based on the number of shares held by each participant. The net asset value per share on any given valuation date is determined by dividing the total market value of the net assets of the common trust by the number of shares of the common trust outstanding on the valuation date. Contributions to and withdrawals from a common trust are based on the net asset value per share on the day of the transaction.



**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

***Intermediate-Term Fixed Income Pool***

The Plan participates in the State's internally managed intermediate-term fixed income pool which was established July 1, 1994, with a start up share price of \$1,000. The share price at June 30, 2005, was \$1,852. Treasury staff determines the allocation between permissible securities. The pool has an intermediate time horizon, a more limited need for liquidity than the money invested in the short-term fixed income pool, a limited need for inflation protection, and can be invested at a moderate risk level. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, the Plan had a 2.60% and 2.04% direct ownership in the intermediate-term fixed income pool.

***International Equity Pool***

The Plan participates in the State's externally managed international equity pool, which was established in April 2000 with a start up share price of \$1,000. The share price at June 30, 2005, was \$963. The external manager independently determines the allocation between permissible securities. The pool has a time horizon that is longer than any of the fixed income investment pools. It has a very limited need for liquidity, a high need for long-term inflation protection and a high-risk tolerance. The net asset value per share on any given valuation date is determined by dividing the total fair value of the net assets of the pool by the number of shares of the pool outstanding on the valuation date. Ownership in the pool is based on the number of shares held by each participant. Contributions to and withdrawals from the pool are based on the beginning of the day net asset value per share on the day of the transaction. At June 30, 2005 and 2004, the Plan had a 10.96% and 13.31% direct ownership in the international equity pool.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

At June 30, 2005, the Plan had the following investments:

Investment type	Fair value				Total
	Short-term fixed income pool	Intermediate- term fixed income pool	Broad market fixed income pool	Other	
Deposits	\$ —	—	—	12,033	12,033
Overnight sweep account	84,119	—	—	—	84,119
Money market	—	—	—	14,848,377	14,848,377
Commercial paper	4,926,412	—	—	—	4,926,412
U.S. treasury bills	3,660,179	—	—	—	3,660,179
U.S. treasury notes	3,178,879	26,198,697	6,624,479	—	36,002,055
U.S. treasury bonds	—	—	7,247,726	—	7,247,726
U.S. treasury strips	—	548,353	1,478,041	—	2,026,394
U.S. government agency discount notes	808,494	3,704,076	249,390	—	4,761,960
U.S. government agency Mortgage-backed	—	7,117,343	5,271,375	—	12,388,718
Other asset-backed	9,238,211	11,159,218	50,811,306	—	71,208,735
Corporate bonds	25,908,121	2,804,025	3,573,504	—	32,285,650
Yankees:	11,750,154	8,460,427	23,855,667	—	44,066,248
Government	—	—	425,589	—	425,589
Corporate	449,824	21,938	514,026	—	985,788
Domestic equity	—	—	—	50,458,975	50,458,975
International equity	—	—	—	18,041,179	18,041,179
Total invested assets	60,004,393	60,014,077	100,051,103	83,360,564	303,430,137
Pool related net assets (liabilities)	472,265	(3,354,363)	(1,576,727)	97,490	(4,361,335)
Other pool ownership	(4,490,790)	703,920	3,786,870	—	—
GeFONSI	(7,184,781)	(6,019,941)	—	13,204,722	—
Net invested assets	\$ 48,801,087	51,343,693	102,261,246	96,662,776	299,068,802

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

**Short-Term Fixed Income Pool**

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2005, the expected average life of individual fixed rate securities ranged from one day to ten months and the expected average life of floating rate securities ranged from less than one year to three years.

**Intermediate-Term and Broad Market Fixed Income Pools**

Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its other fixed income pool portfolios to the following:

Intermediate-term fixed income pool –  $\pm$  20% of the Merrill Lynch 1-5 year Government Bond Index. The effective duration for the Merrill Lynch 1-5 year Government Bond Index at June 30, 2005, was 2.31 years.

Broad market fixed income pool –  $\pm$  20% of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2005, was 4.16 years.

At June 30, 2005, the effective duration by investment type was as follows:

	<b>Effective duration (In years)</b>	
	<b>Intermediate-term fixed income pool</b>	<b>Broad market fixed income pool</b>
U.S. Treasury Notes	2.26	3.91
U.S. Treasury Bonds	—	10.39
U.S. Treasury Strips	0.86	15.97
U.S. Government Agency	3.01	7.00
Mortgage-backed	2.01	2.41
Other Asset-backed	0.84	1.31
Corporate Bonds	2.60	5.39
Yankees:		
Government	—	6.50
Corporate	3.09	9.86
Portfolio Effective Duration	2.10	4.10

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100-basis point change in interest rates. The duration of a pool is the average fair value weighted duration of each security in the pool taking into account all related cash flows.

Treasury uses industry-standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options and other variable cash flows for purposes of the effective duration calculation.

Treasury has no policy with regard to interest rate risk for the money market balance held in the International Equity Pool.

***Credit Risk***

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

Treasury's investment policy has the following limitations with regard to credit risk:

With the exception of the sweep account, short-term fixed income pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset-backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

Intermediate-term and broad market fixed income pool investments are limited to securities with a long-term credit rating of at least BBB3 or equivalent and securities with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is BBB3 or equivalent. Asset-backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA.

Treasury has no policy with regard to credit risk for the money market balance held in the international equity pool.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

At June 30, 2005, the Pools consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard and Poor's Corporation rating scale):

Investment Type	Rating <sup>1</sup>	Short-term fixed income pool	Intermediate- term fixed income pool	Broad market fixed income pool	International equity pool
Money Market	AAA	—%	—%	—%	3%
Commercial Paper	A	8	—	—	—
U.S. Government Agency Discount Notes	Not rated	1	7	—	—
U.S. Government Agency Mortgage-backed	Not rated	—	13	6	—
Mortgage-backed (Agency)	AAA	15	6	11	—
Other Asset-backed	Not rated	—	11	41	—
Other Asset-backed	AAA	39	4	3	—
Corporate Bonds	A	3	1	—	—
Corporate Bonds	AAA	1	1	2	—
Corporate Bonds	AA	11	2	2	—
Corporate Bonds	A	9	6	7	—
Corporate Bonds	BBB	—	6	12	—
Yankees – Corporate	A	1	—	—	—
No Credit Exposure		12	43	16	97
		<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

At June 30, 2005, the securities lending collateral was invested in a registered 2(a)-7 money market fund that was not rated.

***Custodial Credit Risk – Deposits***

Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. Treasury's policy with regard to custodial credit risk is to collateralize state deposits to the extent possible. At June 30, 2005, the Plan's deposits were uncollateralized and uninsured.

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

***Foreign Currency Risk***

The Commissioner of Revenue formally adopts asset allocation policies for the Plan at the beginning of each fiscal year which places policy limitations on the amount of international securities the Plan is allowed to hold. The following policy was in place during fiscal year 2005 and invested assets included the following holdings at June 30, 2005, for the Plan's investment in the international equity Pool:

	<u>Policy</u>	<u>Actual</u>
Retiree Health Insurance Fund, Long Term Care	18% ± 4%	17.39%

At June 30, 2005, the Plan had exposure to foreign currency risk as follows:

<u>Currency</u>	<u>Fair value</u>
Deposits:	
Swiss Franc	\$ 27
Euro Currency	51
Japanese Yen	11,955
	<u>12,033</u>
Investments – international equity:	
Euro Currency	7,565,360
Japanese Yen	3,981,600
Norwegian Krone	213,344
Pound Sterling	4,212,785
Singapore Dollar	206,869
Swiss Franc	1,861,221
	<u>18,041,179</u>
Total	<u>\$ 18,053,212</u>

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

***Concentration of Credit Risk***

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than 5% of a pool's holdings in corporate bonds of any one company or affiliated group. At June 30, 2005, the Plan had more than 5% of their investments in Federal Home Loan Mortgage Corporation and Federal National Mortgage Association as follows:

	<u>Fair value</u>	<u>Percent of total investments</u>
Federal Home Loan Mortgage Corporation	\$ 20,113,679	7%
Federal National Mortgage Association	42,384,164	14

The cost and fair value of the Plan's investments at June 30 was as follows:

	<u>Cost</u>	<u>Fair value</u>
2005:		
Broad market fixed income pool	\$ 102,112,312	102,261,246
Domestic equity account	48,542,872	50,458,975
Intermediate-term fixed income pool	52,368,120	51,343,693
International equity pool	16,808,350	18,615,657
	<u>\$ 219,831,654</u>	<u>222,679,571</u>
2004:		
Broad market fixed income pool	\$ 78,979,165	77,921,033
Domestic equity account	38,799,591	38,035,461
Intermediate-term fixed income pool	35,220,618	34,022,448
International equity pool	14,845,109	16,542,519
	<u>\$ 167,844,483</u>	<u>166,521,461</u>

**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(3) Investments (cont.)**

The Plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in value as follows:

	<u>2005</u>	<u>2004</u>
Quoted fair value in an active market:		
Broad market fixed income pool	\$ 1,760,639	(3,233,534)
Domestic equity account	2,680,235	5,762,184
Intermediate-term fixed income pool	(296,048)	(1,159,075)
International equity pool	<u>1,569,688</u>	<u>2,619,654</u>
	<u>\$ 5,714,514</u>	<u>3,989,229</u>

**(4) Securities Lending**

Alaska Statute 37.10.071 authorizes the Commissioner of Revenue (Commissioner) to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Commissioner entered into an agreement with State Street Corporation (the Bank) to lend fixed income and equity securities. The Bank, acting as the Commissioner's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2005 and 2004, the fair value of securities on loan allocable to the Plan totaled \$14,021,519 and \$29,342,297, respectively.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. International equity security loans are collateralized at not less than 105% of their fair value. Fixed income security loans are collateralized at not less than 102% of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral is invested in a registered 2(a)-7 money market fund, which is valued at amortized cost, which approximates fair value. Maturities of investments in the money market fund generally do not match the maturities of the loaned securities because the lending agreements are terminable at will. Securities collateral may be pledged or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the securities collateral unless the borrower defaults, they are not recorded in the financial statements. Securities on loan, cash collateral and cash collateral payable are recorded in the financial statements. The Bank, the Plan and the borrower receive a fee from earnings on invested collateral. The Bank and the Plan share a fee paid by the borrower for loans not collateralized with cash.



**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(4) Securities Lending (cont.)**

There is limited credit risk associated with the lending transactions since the Commissioner is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the Commissioner against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

**(5) Claims Incurred But Not Paid**

The liability for claims incurred but not paid represents the estimated amounts necessary to settle all outstanding claims, including those incurred but not reported, as of the balance sheet date. The Plan's reserve estimates are based primarily on historical development patterns adjusted for current trends that would modify past experience. Claims are reevaluated periodically to consider the effects of inflation, claims settlement trends and other economic factors. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the health insurance business.

Changes in the balances of claims liabilities follows:

	<u>2005</u>	<u>2004</u>
Beginning of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 991,201	58,372
Outstanding claims included in accrued expenses	880,354	971,151
IBNR	42,900,000	38,750,000
Total, beginning of year	44,771,555	39,779,523
Benefit expense	259,433,330	230,478,237
Benefits paid	255,629,368	225,486,205
Total, end of year	\$ 48,575,517	44,771,555
End of year:		
Due to State of Alaska General Fund for outstanding warrants	\$ 1,641,454	991,201
Outstanding claims included in accrued expenses	664,063	880,354
IBNR	46,270,000	42,900,000
Total, end of year	\$ 48,575,517	44,771,555

**STATE OF ALASKA**  
**RETIREE HEALTH FUND**  
(A Pension Trust Fund of the State of Alaska)

Notes to Financial Statements

June 30, 2005 and 2004

**(6) Transfer to Retirement Systems**

During fiscal year 2004, a review was conducted of all medical reserve amounts. An analysis was conducted which considered: (1) the medical portion of net assets held in trust for benefits and other purposes, (2) prior and current year amounts incurred, but not paid, (3) the amount necessary for the contingency reserve, and (4) the amount necessary for a premium stabilization reserve. The result was an excess amount of net assets not specifically identified to other reserves. The excess amount was then returned to the respective retirement system. There is an earnings differential on invested assets between the base trust fund and the Plan. Earnings on such excess reserves should remain with the base retirement trust. Such an analysis is conducted periodically to determine that reserves are adequate, but not excessive.

Based on this review, the Plan transferred \$20,000,000 to the four contributing retirement systems. The transfers were as follows:

Public Employees' Retirement System	\$ 13,724,000
Teachers' Retirement System	6,200,000
Judicial Retirement System	50,000
Elected Public Officials Retirement System	26,000

**(7) Contingency**

The Plan is a defendant in four similar lawsuits, three of which are class action suits. The lawsuits pertain to whether recent changes to the retiree health insurance program under the Plan resulted in violations of members' constitutional rights to retirement benefits. The Superior Court granted summary judgment in favor of the plaintiffs on the issue of liability, and the Alaska Supreme Court granted the Plan's petition for review. Following briefing and argument, the Supreme Court reversed the Superior Court and remanded for further proceedings. This issue is now pending in the Superior Court for a determination of the matter in accordance with the Supreme Court's instructions. The Plan has not recorded the financial impact of this suit, because an unfavorable outcome in this matter is, in management's opinion, not considered probable, but rather only possible, and the potential loss, if any, cannot be reasonably estimated at this time. If an unfavorable outcome occurs, the costs would be passed through to employers through the normal contribution process.

The State was a defendant in a lawsuit filed by the Alaska Civil Liberties Union and a number of same-sex couples with regards to the statutes limiting employee health insurance coverage to employees and their spouses and dependents, thus excluding coverage for domestic partners of employees. An adverse ruling against the State was issued on October 28, 2005. The effect of this ruling will increase the number of persons covered by insurance paid by the Plan. The court ruling states that the Plan's current benefit program will remain in effect until the issue of remedies is resolved. The potential effect of this ruling cannot be reasonably estimated until the issue of remedies is resolved. As such, the Plan has not recorded the financial impact of this ruling. The costs associated with this ruling will be passed through to employers through the normal contribution process.







**STATE OF ALASKA  
RETIREE HEALTH FUND**

Letter to the State of Alaska  
Division of Retirement and Benefits

September 30, 2005



**KPMG LLP**  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

September 30, 2005

Division of Retirement and Benefits  
State of Alaska Retiree Health Fund  
Juneau, Alaska

Ladies and Gentlemen:

We have audited the financial statements of the State of Alaska Retiree Health Fund (Plan), for the year ended June 30, 2005, and have issued our reports thereon dated September 30, 2005. Under our professional standards, we are providing you with the attached information related to the conduct of our audit.

#### **Our Responsibility Under Professional Standards**

We have a responsibility to conduct our audit of the financial statements in accordance with professional standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

In addition, in planning and performing our audit of the financial statements, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit of the financial statements does not include examining the effectiveness of internal control and does not provide assurance on internal control.

#### **Accounting Policies and Alternative Treatments**

##### ***Significant Accounting Policies***

The significant accounting policies used by the Plan are described in note 2 to the financial statements. There were no changes in the Plan's accounting policies during the year.

##### ***Quality of Accounting Principles***

We have discussed with the audit committee and management our judgments about the quality, not just the acceptability, of the Plan's accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the Plan's accounting policies and their application, and the understandability and completeness of the Plan's financial statements, which include related disclosures.

#### **Management Judgments and Accounting Estimates**

The preparation of the financial statements requires management of the Plan to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent



Division of Retirement and Benefits  
State of Alaska Group Health and Life Fund and Retiree Health Fund  
September 30, 2005  
Page 2

assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

During the financial reporting process, management of the Plan prepares two significant estimates: the valuation of its investment portfolio, and the calculation of reserves for estimated claims incurred but not paid. The Plan's investments are carried at fair value. The methods used by the Plan to determine fair values of investment securities are disclosed in note 2 to the financial statements. The reserves for estimated claims incurred but not paid has been calculated by the Plan's actuary and adjusted for certain factors. We evaluated the key factors and assumptions used to develop management's judgments and estimates in determining that amounts recorded were reasonable in relation to the financial statements of the Plan taken as a whole.

#### **Audit Adjustments and Uncorrected Misstatements**

##### ***Audit Adjustments***

We did not propose any adjustments arising from the audit that could, in our judgment, either individually or in the aggregate, have a significant quantitative or qualitative effect on the Plan's financial reporting process.

##### ***Uncorrected Misstatements***

In connection with our audit of your financial statements, we have not discussed with management any significant financial statement misstatements that have not been corrected for in your books and records as of and for the year ended June 30, 2005.

#### **Other Information in Documents Containing Audited Financial Statements**

Our responsibility for other information in documents containing the Plan's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents, for example, Management's Discussion and Analysis of Financial Condition and Results of Operations. We have, however, read the other information included in the Plan's Comprehensive Annual Financial Report, and no matters came to our attention that cause us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

#### **Disagreements with Management**

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our auditors' report on the Plan's financial statements.

#### **Consultation with Other Accountants**

To the best of our knowledge management has not consulted with or obtained opinions, written or oral, from other independent accountants during the past year that were subject to the requirements of Statement on Auditing Standards No. 50, *Reports on the Application of Accounting Principles*.



Division of Retirement and Benefits  
State of Alaska Group Health and Life Fund and Retiree Health Fund  
September 30, 2005  
Page 3

### **Major Issues Discussed with Management Prior to Retention**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention each year as the Plan's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### **Difficulties Encountered in Performing the Audit**

We encountered no difficulties in dealing with management in performing our audits.

### **Material Written Communications**

Attached to this report please find copies of the following material written communications between management and us:

- 1) Management representation letter; and
- 2) Management letter

### **Independence**

We are not aware of any independence-related relationships between our firm and the Plan other than the professional services that have been provided to the Plan.

### ***Confirmation of Audit Independence***

We hereby confirm that as of September 30, 2005, we are independent accountants with respect to the Plan under all relevant professional and regulatory standards.

### **Fees from Management Advisory Services**

There were no fees received from the Plan during 2005 for management advisory services.

\* \* \* \* \*

This report to the State of Alaska and the Division of Retirement and Benefits is intended solely for the information and use of the aforementioned members and management and is not intended to be and should not be used by anyone other than these specified parties. This report is not intended for general use, circulation or publication and should not to be published, circulated, reproduced or used for any purpose without our prior written permission in each specific instance.

Very truly yours,

**KPMG LLP**



# STATE OF ALASKA

## DEPARTMENT OF ADMINISTRATION

DIVISION OF RETIREMENT AND BENEFITS

FRANK H. MURKOWSKI, GOVERNOR

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TOLL-FREE 1-800-821-2251

KPMG LLP  
701 West 8<sup>th</sup> Avenue, Suite 600  
Anchorage, AK 99501

September 30, 2005

Ladies and Gentlemen:

We are providing this letter in connection with your audits of the statements of plan net assets of the **State of Alaska Retiree Health Fund**, a pension trust fund of the State of Alaska (the Plan) as of June 30, 2005 and 2004, the related statements of changes in net plan assets for the years then ended and the required supplemental schedules of funding progress and employer contributions, and the additional schedules of administrative and investment expenses and payments to consultants other than investment advisors. We understand that your audits were made for the purpose of expressing an opinion as to whether these financial statements present fairly, in all material respects, the financial status of the Plan and the changes in its financial status in conformity with accounting principles generally accepted in the United States of America and whether the supplemental schedules are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

Any representations made in this letter are representations only in regard to those activities that are under the control of the Division of Retirement and Benefits, Department of Administration, and also only in so far as the applicable law, regulations, and rules that apply, are those that apply to a governmental plan.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America and the notes include all disclosures required by laws and regulations to which the Plan is subject, including DOL Rules and Regulations for Reporting and Disclosure, if applicable to a governmental plan.
2. We have made available to you:

KPMG LLP  
State of Alaska Retiree Health Fund  
September 30, 2005  
Page 2

- a. All financial records and related data maintained by the Division of Retirement and Benefits.
  - b. All minutes of the meetings of the Board or summaries of actions of recent meetings for which minutes have not yet been prepared.
  - c. Actuarial reports prepared for the Plan and the Plan's sponsor during the year.
3. Except as disclosed to you in writing, there have been no:
  - a. Circumstances that have resulted in communications from the Plan's external legal counsel to either the Plan sponsor or Plan administrator reporting evidence of a material violation of securities law, breach of fiduciary duty or similar violation by the Plan sponsor or any agent thereof.
  - b. False statements affecting the Plan's financial statements made to you, or the Plan and Plan Sponsor's internal auditors.
  - c. Communications from regulatory agencies, including the U.S. Department of Labor (DOL), the Internal Revenue Service (IRS) and the Pension Benefit Guarantee Corporation (PBGC) concerning noncompliance with, or deficiencies in, financial reporting practices.
4. There are no:
  - a. Violations or possible violations of laws or regulations (including IRS, DOL and PBGC regulations), whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
  - b. Unasserted claims or assessments that our lawyers have advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting For Contingencies*.
  - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SFAS No. 5.
  - d. Material transactions that have not been properly recorded in the accounting records underlying the financial statements.
  - e. Events that have occurred subsequent to the Plan's year-end and through the date of this letter that would require adjustment to or disclosure in the financial statements.
  - f. Other reportable transactions (e.g., breach of fiduciary responsibilities or events that may jeopardize the tax status).

KPMG LLP  
State of Alaska Retiree Health Fund  
September 30, 2005  
Page 3

5. With regard to the internal controls in place at the Division of Retirement and Benefits, there are no reportable conditions in the design or operation of internal control over financial reporting, which could adversely affect the Plan's ability to record, process, summarize and report financial data, and we have identified no material weaknesses in internal control over financial reporting.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud for those activities actually under the control of the Division of Retirement and Benefits. We understand that the term "fraud" includes misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

Misstatements arising from fraudulent financial reporting are intentional misstatements, or omissions of amounts or disclosures in financial statements to deceive financial statement users. Misstatements arising from misappropriation of assets involve the theft of a Plan's assets where the effect of the theft causes the financial statements not to be presented in conformity with accounting principles generally accepted in the United States of America.

7. We have no knowledge of any fraud or suspected fraud affecting the entity involving:

- a. Management of the Plan or Plan Sponsor
- b. Employees of the Plan or Plan Sponsor who have significant roles in internal control, or
- c. Others where the fraud could have a material effect on the financial statements.

8. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, third-party service providers, trustee/custodian, regulators, or others.

9. There are no uncorrected financial statement misstatements that are material, either individually or in the aggregate, to the basic financial statements taken as a whole.

10. The Plan and the Plan Sponsor have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, nor do we have any present plans or intentions to terminate, freeze or merge the Plan.

11. We have no knowledge of any officer or director of the Plan or the Plan Sponsor, or any other person acting under the direction thereof, having taken any action to fraudulently influence, coerce, manipulate or mislead you during your audit.

12. We believe that the carrying amounts of all material assets are recoverable.

KPMG LLP  
State of Alaska Retiree Health Fund  
September 30, 2005  
Page 4

13. The Plan has complied with all aspects of debt and other contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
14. We have provided to you documentation of all amendments made to the plan instrument, trust agreement or insurance contracts during the Plan year through the date of this letter, including amendments to comply with applicable laws.
15. All required filings of the Plan and trust documents have been filed with the appropriate regulatory agencies.
16. There were no omissions from the participants' data provided to the Plan's actuary for the purpose of determining the actuarial present value of accumulated plan benefits and other actuarially determined amounts in the financial statements.
17. We agree with the actuarial methods and assumptions used by the Plan's actuary for funding purposes and for determining accumulated plan benefits are appropriate in the Plan's circumstances. We did not give any, nor cause any, instruction to the Plan's actuary with respect to values or amounts derived, and we are not aware of any matters that have impacted the independence or objectivity of the Plan's actuary.
18. There have been no changes in:
  - a. The actuarial methods or assumptions used in calculating amounts recorded or disclosed in the financial statements.
  - b. Plan provisions between the actuarial valuation date and the date of this letter.
19. The plan and the trust established under the Plan is qualified under the appropriate section of the Internal Revenue Code and intends to continue as a qualified plan and trust.
20. The operation of the Plan and trust has been in accordance with IRS and DOL rules and regulations.
21. The following have been properly recorded or disclosed in the financial statements and supplemental schedules:
  - a. With the exception of transactions related to investment assets, related party transactions, including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments and amounts receivable from or payable to related parties and transactions with parties in interest; including sales, purchases, loans, transfers, segregation of employee contributions from general assets, leasing arrangements, administrative services, guarantees and amounts receivable from or payable to related parties.

KPMG LLP  
State of Alaska Retiree Health Fund  
September 30, 2005  
Page 5

We understand that Section 3(14) of ERISA defines a "party in interest" to include fiduciaries or employees of the plan, any person who provides services to the plan, an employer whose employees are covered by the plan, an employee organization whose members are covered by the plan, a person who owns 50 percent or more of such an employer or employee association, or relatives of such persons just listed. Although not identical, ERISA defines "parties in interest" in much the same way as FASB Statement No. 57, *Related Party Disclosures*, defines the term *related parties*. We understand the term "related party" refers to affiliates of the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

- b. Guarantees, whether written or oral, under which the Plan is contingently liable, including guarantee contracts and indemnification agreements pursuant to FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.
- c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. Significant estimates are estimates at the date of the statement of net assets which could change materially within the next year. Concentrations refer to the nature and type of individual investments, volumes of business, revenues, available sources of supply, or markets or geographic areas for which it is reasonably possible that events could occur which would significantly disrupt normal finances within the next year. Concentrations include material sources of financing, including off-balance sheet arrangements and transactions with unconsolidated, limited purpose entities, and contingencies inherent in the arrangements, that are reasonably likely to affect the continued availability of liquidity and financing.
- d. Amendments to the plan instrument, if any.
- e. Changes in accounting principles affecting consistency.


KPMG LLP  
State of Alaska Retiree Health Fund  
September 30, 2005  
Page 6

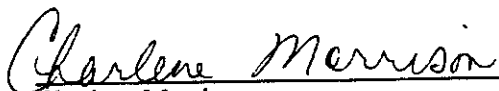
22. Receivables reported in the financial statements represent valid claims arising on or before the date of the statement of net assets and appropriate provisions have been appropriately reduced to their estimated net realizable value.
23. The State of Alaska Retiree Health Fund has implemented GASB Statement No. 40, *Deposits and Investment Risk Disclosures*.

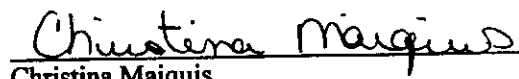
Further, we confirm that we are responsible for the fair presentation in the financial statements of the financial status of the Plan, and changes in its financial status in conformity with accounting principles generally accepted in the United States of America, and for the fair presentation of the accompanying supplemental schedules in relation to the basic financial statements taken as a whole and in accordance with the Department of Labor's Rules and Regulations for Reporting. The financial statements and related footnotes are fairly presented in conformity with generally accepted accounting principles and the notes include all disclosures required by laws and regulations to which the plan is subject. We also acknowledge that we are responsible for the Plan's operation in compliance with IRS and DOL rules and regulations, as those rules and regulations are applicable to a governmental plan.

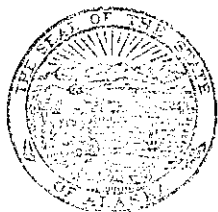
Very truly yours,

State of Alaska  
Retiree Health Fund

  
\_\_\_\_\_  
Melanie Millhorn  
Director, Division of Retirement and Benefits

  
\_\_\_\_\_  
Charlene Morrison  
Chief Financial Officer, Division of Retirement and Benefits

  
\_\_\_\_\_  
Christina Maiquis  
Accountant, Division of Retirement and Benefits



## Alaska State Pension Investment Board

P.O. Box 110405  
Juneau, Alaska 99811-0405  
(907) 465-3749

KPMG LLP  
701 West 8<sup>th</sup> Avenue, Suite 600  
Anchorage, AK 99501

September 30, 2005

Ladies and Gentlemen:

We are providing this letter in connection with your audits of the statements of fiduciary net assets available for benefits of the **State of Alaska Retiree Health Fund**, a Pension Trust Fund of the State of Alaska (the Plan) as of June 30, 2005 and 2004, the related statements of changes in fiduciary net plan assets for the years then ended and the required supplemental schedules of funding progress and employer contributions, and the additional schedules of administrative and investment expenses and payments to consultants other than investment advisors that you have performed for the Division of Retirement and Benefits (R&B). We understand that your audits were made for the purpose of expressing an opinion as to whether these financial statements present fairly, in all material respects, the financial status of the Plan and the changes in its financial status in conformity with accounting principles generally accepted in the United States of America and whether the supplemental schedules are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

Our response is limited in so far that it pertains to the invested assets of the Plan. We are not responsible for, nor are we involved in, the accounting for any part of the Plan's daily non-investment operations.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP  
State of Alaska Retiree Health Fund  
Alaska State Pension Investment Board  
September 30, 2005  
Page 2

2. We have made available to you:
  - a. All financial records and related data.
  - b. All minutes of the meetings of the Alaska State Pension Investment Board or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. Except as disclosed to you in writing, there have been no:
  - a. Circumstances that have resulted in communications from the Plan's external legal counsel to either the Plan sponsor or Plan administrator reporting evidence of a material violation of securities law, breach of fiduciary duty or similar violation by the Plan sponsor or any agent thereof.
  - b. False statements affecting the Plan's financial statements made to you, or the Plan and Plan Sponsor's internal auditors.
4. There are no:
  - a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
  - b. Unasserted claims or assessments that our lawyers have advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting For Contingencies*.
  - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SFAS No. 5.
  - d. Material transactions that have not been properly recorded in the accounting records underlying the financial statements.
  - e. Events that have occurred subsequent to the Plan's year-end and through the date of this letter that would require adjustment to or disclosure in the financial statements.
  - f. Other reportable transactions (e.g., breach of fiduciary responsibilities or events that may jeopardize the tax status).



KPMG LLP  
State of Alaska Retiree Health Fund  
Alaska State Pension Investment Board  
September 30, 2005  
Page 3

g. Assets held for investment purposes that were in default or that were considered to be uncollectible.

5. There are no reportable conditions in the design or operation of internal control over financial reporting, which could adversely affect the Plan's ability to record, process, summarize and report financial data, and we have identified no material weaknesses in internal control over financial reporting.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud. We understand that the term "fraud" includes misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

Misstatements arising from fraudulent financial reporting are intentional misstatements, or omissions of amounts or disclosures in financial statements to deceive financial statement users. Misstatements arising from misappropriation of assets involve the theft of a Plan's assets where the effect of the theft causes the financial statements not to be presented in conformity with accounting principles generally accepted in the United States of America.

7. We have no knowledge of any fraud or suspected fraud affecting the entity involving:

a. Management of the Plan or Plan Sponsor

b. Employees of the Plan or Plan Sponsor who have significant roles in internal control, or

c. Others where the fraud could have a material effect on the financial statements.

8. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, third-party service providers, trustee/custodian, regulators, or others.

9. There are no uncorrected financial statement misstatements that are material, either individually or in the aggregate, to the basic financial statements taken as a whole.

10. We believe that the carrying amounts of all material assets are recoverable.

11. The Plan has complied with all aspects of debt and other contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

KPMG LLP  
 State of Alaska Retiree Health Fund  
 Alaska State Pension Investment Board  
 September 30, 2005  
 Page 4

12. The following have been properly recorded or disclosed in the financials statements and supplemental schedules:

- a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments and amounts receivable from or payable to related parties and transactions with parties in interest; including sales, purchases, loans, transfers, segregation of employee contributions from general assets, leasing arrangements, administrative services, guarantees and amounts receivable from or payable to related parties.

We understand that Section 3(14) of ERISA defines a "party in interest" to include fiduciaries or employees of the plan, any person who provides services to the plan, an employer whose employees are covered by the plan, an employee organization whose members are covered by the plan, a person who owns 50 percent or more of such an employer or employee association, or relatives of such persons just listed. Although not identical, ERISA defines "parties in interest" in much the same way as FASB Statement No. 57, *Related Party Disclosures*, defines the term *related parties*. We understand the term "related party" refers to affiliates of the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

- b. Guarantees, whether written or oral, under which the Plan is contingently liable, including guarantee contracts and indemnification agreements pursuant to FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.
- c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. Significant estimates are estimates at the date of the statement of net assets which could change materially within the next year. Concentrations refer to the

KPMG LLP  
 State of Alaska Retiree Health Fund  
 Alaska State Pension Investment Board  
 September 30, 2005  
 Page 5

nature and type of individual investments, volumes of business, revenues, available sources of supply, or markets or geographic areas for which it is reasonably possible that events could occur which would significantly disrupt normal finances within the next year. Concentrations include material sources of financing, including off-balance sheet arrangements and transactions with unconsolidated, limited purpose entities, and contingencies inherent in the arrangements, that are reasonably likely to affect the continued availability of liquidity and financing.

- d. Changes in accounting principles affecting consistency.
13. The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements
    - a. Extent, nature, and terms of financial instruments with off-balance-sheet risk.
    - b. The amount of credit risk of financial instruments with off-balance-sheet credit risk and information about the collateral supporting such financial instruments; and
    - c. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments.
  14. For those contracts carried at fair value in the financial statements, the Plan's estimate of fair value is based on the best information available in the circumstances, including current market transactions where available. For those contracts where current market transactions are not available, the Plan's valuation models for determining fair value consider recent spot prices, forward prices, and for its option pricing models, the volatility implied by recent transactions.
  15. The Plan and the Plan Sponsor have no plans or intentions that may materially affect the carrying value or classification of invested assets.
  16. The State of Alaska Retiree Health Fund has implemented GASB Statement No. 40, *Deposits and Investment Risk Disclosures*.

Further, we confirm that we are responsible for the fair presentation in the financial statements of the financial status of the Plan, and changes in its financial status in conformity with accounting principles generally accepted in the United States of America, and for the fair presentation of the accompanying supplemental schedules in relation to the basic financial statements taken as a whole and in accordance with the Department of Labor's Rules and

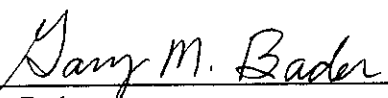
KPMG LLP  
State of Alaska Retiree Health Fund  
Alaska State Pension Investment Board  
September 30, 2005  
Page 6

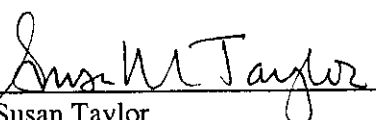
Regulations for Reporting. The financial statements and related footnotes are fairly presented in conformity with generally accepted accounting principles.

Very truly yours,

STATE OF ALASKA RETIREE HEALTH FUND

Alaska State Pension Investment Board

  
\_\_\_\_\_  
Gary Bader  
Chief Investment Officer

 9/22/05  
\_\_\_\_\_  
Susan Taylor  
Comptroller



**STATE OF ALASKA  
RETIREE HEALTH FUND**  
(An Internal Service Fund of the State of Alaska)

Management Letter

September 30, 2005



KPMG LLP  
Suite 600  
701 West Eighth Avenue  
Anchorage, AK 99501

September 30, 2005

Division of Retirement and Benefits  
State of Alaska Retiree Health Fund  
Juneau, Alaska

Ladies and Gentlemen:

We have audited the financial statements of the State of Alaska Retiree Health Fund (Plan), for the year ended June 30, 2005, and have issued our report thereon dated September 30, 2005. In planning and performing our audits of the financial statements of the Plan, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the Plan.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. We have not considered internal control since the date of our report. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the members of the Division of Retirement and Benefits and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP